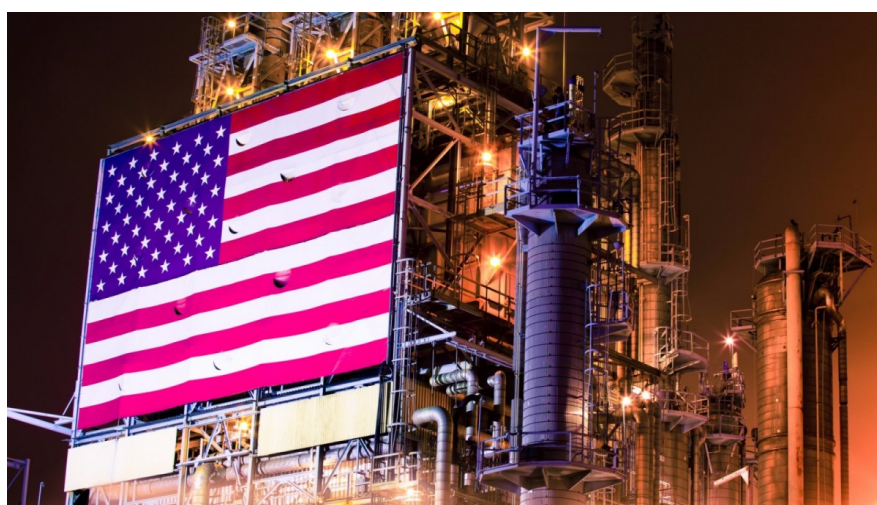


US data points to a more aggressive Fed response

Core US inflation is rising and with retail sales booming the chances of four 2018 Fed rate hikes is looking more and more real



Source: iStockphoto

11.3% 3M annualised rate of growth in retail sales seen in December

US headline inflation has fallen to 2.1%YoY in December from November's 2.2% due mainly to gasoline prices. This was widely expected, but the increase in the annual rate of core inflation certainly wasn't, especially after Thursday's soft PPI report. The rise in the core rate to 1.8% YoY from 1.7% was led mainly by a stronger outturn from the housing and medical care components.

If inflation rises as we suspect then this will only heighten market expectations that the risk is skewed towards a more aggressive series of Federal Reserve rate hikes

The drop in the headline inflation rate is only going to be temporary given the latest rise in oil prices while we expect to see a rebound in apparel prices in coming months after a very unusual set of four consecutive monthly price falls. Moreover, the combination of strong growth, higher oil prices, dollar declines, cell phone data plan quirks and rising pay means, we're looking for CPI to hit 3% this summer with core inflation set to soon break above 2%.

At the same time, consumer spending shows no sign of slowing. US retail sales jumped another 0.4% MoM with decent upward revisions to the history, as rising household incomes, soaring confidence and a growing appetite for consumer debt fuel spending growth. Three-month annualised retail sales growth remains in double digits (11.3%)

With the US' activity story benefiting from strong domestic momentum and rapidly improving global demand, we continue to look for US GDP to expand by 3% this year.

If inflation rises as we suspect then this will only heighten market expectations that the risk is skewed towards a more aggressive series of Federal Reserve rate hikes. We currently are looking for three rate hikes in 2018, but see a growing threat that it will be four.

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